Chapter 4

IFRS Harmonization and Foreign Direct Investment

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ABSTRACT

IFRS refers to International Financial Reporting Standards, which are the guidelines that provide the framework for accounting works. The principles are also known as the International Accounting Standards (IAS). This global financial concept was first introduced in 2001 to equip investors with analyzed accounting statements. In this Chapter we review the relation between IFRS and Foreign Direct Investments (FDIs). We review the relevant literature that analyses the effects on IFRS on FDIs and cross-border acquisitions. The economic literature states that the introduction of IFRS has presented an important increase in FDIs. The evidence shows that IFRS adopting countries attract investments from countries that implemented IFRS and non-IFRS implementing countries.

INTRODUCTION

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BACKGROUND AND LITERATURE REVIEW

The notion of unifying accounting principles dates back to the early 19th century. It is at this time that the concept of international financial standards originated, specifically during the first Global Congress of Accountants held at St. Louis in 1904 (Fritz & Lammle, 2003, p. 3). At the conference, the need for harmonization and cooperation in the accounting field was emphasized. Despite the initiative, differences in the accounting principles still abound, mainly because the dissimilarities in legal systems, the manner in which providers of capital operate, taxation systems, national cultures, and general accounting practices. The differences hindered investors from obtaining clear financial information, which is vital for strategic planning. Thus, international trade was constrained; countries experienced unequal opportunities as a result of the dissimilarities. In this regard, the inequalities and unclear financial statements were the main reasons behind the call for financial standardization.

1. The Accounting Harmonization Process

In harmonizing the accounting standards, different approaches were and still are being employed (Fritz & Lammle, 2003, p. 3). To enable accurate depiction of the process, harmonization can be viewed from different angles. First the process can be shown as a timeline and then depicted as a series of trait junctions. The timeline follows the steps and achievements made by the International Accounting Standards Committee (IASC) since the early 1960s.

1.1 Pre-Stage of the Harmonization Process

Jacob Kraanyehorf was the pioneer of financial unification. He released his first concept paper on the subject in 1959; through the document, Kraanyehorf campaigned for the international acceptance of economic unification (Fritz and Lammle, 2003, p. 21). To strengthen his proposal, he noted the advantages of a unified financial front such as elevated global loaning and easy trading that come with identification and appreciation of differences among countries. As a result of Kraanyehorf efforts, the International Accounts Study Group (IASG) was formulated in 1966 to help analyze and eliminate the differences in financial documentation between Canada and the United Kingdom. The Americans were not as enthusiastic about harmonization in the early 1960s, but changed their viewpoint in 1972 after one of their professional accounting bodies held discussions with six other nations, including Germany, Japan, China, the United Kingdom, and Canada (Fritz and Lammle, 2003, p. 21).

1.2 Harmonization between 1973 and 1987

The International Accounting Standards Committee (IASC) was slowly developed between 1973 and 1987. This body was responsible for a considerable number of the standards set during the 14-year period. Particularly, the institution dealt with the problem of inventory recording. In this case, the main objective of the IASC was to ascertain compatibility between the new set guidelines and those established by the IASG (Fritz & Lammle, 2003, p. 23). Besides that, during the period, the unpopular global measurement methods, such as the austerity metrics, were eliminated. All standards were incorporated through